

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF TENNESSEE
SOUTHERN DIVISION

In re:

Case No. 00-16780
Chapter 7

HARVEY YARBROUGH
CHARLOTTE YARBROUGH

Debtors

JOE E. YARBROUGH, CATHY R.
DARROW AND QUICK WELD
MFG., INC.,

Adv. Pro. No. 01-1052

Plaintiffs

v.

HARVEY YARBROUGH and
CHARLOTTE YARBROUGH,

Defendants

MEMORANDUM OF LAW
ON THE ISSUE OF NON-DISCHARGEABLE DAMAGES

Appearances: Michael S. Rosenthal, Wagner, Johnston & Rosenthal, P.C., Atlanta, Georgia, and Scott N. Brown, Jr., Spears, Moore, Rebman & Williams, Chattanooga, Tennessee,
Attorneys for Plaintiffs

Albert L. Watson, III, Chattanooga, Tennessee, Attorney for Defendant

R. Thomas Stinnett, United States Bankruptcy Judge

This matter came before the court as a shareholders' derivative action as well as individual actions in a complaint to determine dischargeability pursuant to 11 U.S.C. § 523(a)(2), (4), and (6). This court has jurisdiction pursuant to 28 U.S.C. § 1409, and this is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(I). Following a trial in this matter, the court reserved the issue of damages. Having considered the post-trial briefs by the parties and the record as a whole, the court reaches the following conclusions with respect to the issue of damages.

Plaintiffs Joe E. Yarbrough and Cathy Darrow were minority shareholders in a Georgia corporation known as Quick Weld Manufacturing, Inc., ("Quick Weld"), which is also a plaintiff in this proceeding. Plaintiff Joe E. Yarbrough's brother, Harvey Yarbrough, and sister-in-law, Charlotte Yarbrough, were majority shareholders, officers and directors of Quick Weld. Plaintiff Cathy Darrow is Joe Yarbrough's daughter. The plaintiffs allege that a pre-bankruptcy sale of Quick Weld to the ITW Devcon division of Illinois Tool Works, Inc., marked the culmination of a history of fraud, abuse of corporate assets, conversion, embezzlement and breach of fiduciary duty by the debtors, and that the debtors crowned their efforts by diverting the lion's share of the proceeds from the sale to their own pockets. In particular, the plaintiffs allege that the debtors

treated Quick Weld's bank account as a personal account, diverting funds into and out of the account as needed for personal and household expenditures. Plaintiffs initiated this proceeding against both debtors pursuant to 11 U.S.C. § 523(a)(2), (4) and (6); however, in a separate action, the husband, Harvey Yarbrough, was denied his discharge, and he is no longer a defendant in this case. At the trial, Charlotte Yarbrough confirmed that she wrote checks for personal and family use from the Quick Weld business account, and deposited certain items payable to Quick Weld into an account designated as "Church of God" rather than to Quick Weld's business account. Charlotte Yarbrough also testified, with respect to an alleged diversion of proceeds from the sale of Quick Weld, that she had no personal knowledge of the diversion and no knowledge of what happened to those funds after the sale of the corporation. At the conclusion of the proof in the trial, the court rendered an opinion on the record, finding Charlotte Yarbrough liable for embezzlement pursuant to 11 U.S.C. § 523(a)(4). The court reaffirms that opinion. The court reserved the issue of damages and the parties submitted briefs setting forth their arguments with respect thereto.

The plaintiffs contend that they are entitled to actual monetary damages in the amount of funds diverted by Charlotte Yarbrough from Quick Weld, punitive damages of \$500,000.00, costs and attorneys' fees.

At trial, the plaintiffs tendered exhibits categorized into five areas: Category 1 is the "Church of God" account to which deposits were made of funds allegedly belonging to Quick Weld, and from which various withdrawals were made for Charlotte Yarbrough's personal expenses and construction of a house. Category 2 consists of withdrawals from the Quick Weld business account for home construction expenses incurred by the debtors. Category 3, entitled "Loans," sets forth the amounts allegedly loaned by Quick Weld to the Yarbroughs, or vice versa.

Category 4 concerns amounts allegedly obtained by Charlotte and Harvey Yarbrough from funds placed in escrow in the Superior Court Clerk's Office of Catoosa County, Georgia, in a state court proceeding involving the sale of Quick Weld prior to the Yarbroughs' bankruptcy. Category 5 consists of "Miscellaneous Embezzled Funds" withdrawn from Quick Weld's account by Charlotte Yarbrough for personal expenses. The Court addresses each of the categories and the exhibits tendered in support thereof.

The exhibits in Category I consist of copies of checks payable to Quick Weld and Rock Weld¹ from various sources and deposited by Charlotte or Harvey Yarbrough to an account entitled "Church of God." The evidence at trial established that this account has no connection with any charitable or religious organization but was used as a personal checking account. Also included in plaintiffs' exhibits are copies of withdrawals from the "Church of God" account for various personal expenses. Without a detailed tracing of each and every deposit to the account, however, the court cannot determine whether the entire balance of the "Church of God" account, at any given time, consisted exclusively of funds improperly credited to the account which should have been credited to a Quick Weld account. As such, the Court is reluctant to conclude that every withdrawal from the account was traceable solely to funds belonging to Quick Weld. The Court recognizes, however, that the exhibits containing items payable to Quick Weld but deposited to the "Church of God" account represent embezzled funds. In reviewing the exhibits, the court notes that the plaintiffs have included summary totals of copies of the exhibits; however, some of the summary pages include amounts for which there is no corresponding item. Also, some of the

¹Rock Weld was a corporation related to Quick Weld in that it was engaged in the same business, i.e., the manufacture of an epoxy-type putty or repair material. The debtors' son, now deceased, acted as president and vice-president of Rock Weld prior to his death on September 23, 1995.

items are checks written by Harvey Yarbrough, who is not a party; therefore, these items have been deducted from the court's calculation. Furthermore, the plaintiffs have included in their exhibits copies of checks made payable to Rock Weld. Rock Weld is not a party to this suit, nor have the plaintiffs established any connection to Rock Weld that would entitle them to any damages from any alleged embezzlement of funds from Rock Weld. Therefore, absent proof that these checks were to have been credited to Quick Weld, the Court will not include these amounts in its calculation. Finally, the plaintiffs included two items payable to Harvey and Charlotte Yarbrough from the Georgia Department of Revenue and from State Farm Insurance Company. Nothing in the record indicates that these funds were unlawfully obtained by Charlotte Yarbrough, and without proof to the contrary, the Court will not include these amounts. With the changes described herein, the Court makes the following adjustments:

Damages Alleged by Plaintiffs: \$229,313.40

<u>Exhibit No.:</u>	<u>Amount Alleged by Plaintiffs:</u>	<u>Adjustments:</u>
38	\$527.18	(\$94.00) - Georgia Dept. of Revenue check payable to debtors
62	\$20,955.05	(\$20,955.05) - Repeated as Exhibit 249
347	\$ 6,150.34	Unchanged
348	\$ 4,078.37	Unchanged
349	\$35,584.36	(\$14,281.70) - Payable to Rock Weld
350	\$ 7,210.80	(\$ 328.80) - Payable to Rock Weld
351	\$66,311.90	(\$66,311.90) - Checks written by Harvey Yarbrough
352	\$38,386.06	(\$ 617.15) - Insurance proceeds payable to Harvey and Charlotte Yarbrough (\$ 630.33) - Appears on summary page with no item (\$23,979.66) - Checks written by Harvey Yarbrough

366	\$20,889.16	(\$20,889.16) - Withdrawals from Church of God account
249	\$20,955.05	(\$ 2,000.00) - Payable to Rock Weld (\$ 6,325.45) - Payable to Rock Weld (\$ 9,000.00) - Check written by Harvey Yarbrough
277	\$21,003.00	Unchanged
56	\$2,300.00	(\$ 2,300.00) - Withdrawals from Church of God account
127	\$3,900.00	(\$ 3,900.00) - Withdrawals from Church of God account
128	\$1,050.00	(\$ 1,050.00) -Withdrawals from Church of God account
129	\$255.00	(\$ 255.00) - Withdrawals from Church of God account
133	\$911.82	(\$ 911.82) - Withdrawals from Church of God account

Adjusted Damages: \$ 79,979.40

Category two consists of withdrawals by Charlotte Yarbrough from the Quick Weld business account for personal expenses incurred in home construction. Also included is \$66,710.00 which represents proceeds paid by Quick Weld to Nations Credit for a personal loan to Charlotte and Harvey Yarbrough. The supporting exhibits include a partial copy of what appears to be a loan document bearing the Yarbroughs' signatures, dated March 20, 1994, in the amount of \$63,104.52. The document contains little other information, including the identity of the lender, nor does it include any record of how or to whom the funds were disbursed. The exhibit also includes a copy of the Quick Weld Disbursements Journal, which reflects payments to Nations Credit on five different occasions in 1994 for amounts totaling \$66,710.72. Plaintiffs contend that these amounts represent the principle and interest accrued on the March 20, 1994,

Nations Credit loan. Charlotte Yarbrough offered nothing in defense or explanation of this transaction; therefore, the loan amount and the interest accrued thereon is included in the calculation of damages. Furthermore, as in the previous category, the plaintiffs have included summary pages of batch exhibits; however, certain items appear only on the summary page and not in the exhibit. Therefore, the amounts of these items have been excluded from the calculation of damages. The exhibits are set forth herein with the adjustments noted:

Damages Alleged by Plaintiffs: \$282,314.69

<u>Exhibit No.</u>	<u>Amount Alleged By Plaintiffs:</u>	<u>Adjustments:</u>
362	\$12,000.00	(\$12,000.00) - Check written by Harvey Yarbrough
363	\$66,710.00	No adjustments
365	(-0-)	Loan Documentation
364	(-0-)	Quick Weld Board Resolutions
361	\$41,117.19	(\$719.00) Omitted from Exhibit (\$898.15) Omitted from Exhibit (\$2,100.00) Omitted from Exhibit
360	\$15,085.00	(\$3,385.00) - Check written by Harvey Yarbrough (500.00) - Check written by Harvey Yarbrough
64	\$116,809.75	(\$60,029.18) - Checks written by Harvey Yarbrough (\$15,085.00) - Repeated as Exhibit 360
65	\$ 29,872.75	(\$5,708.98) - Checks written by Harvey Yarbrough
Adjusted Damages:		\$181,889.38

Category three consists of alleged loans from Quick Weld to Harvey and Charlotte Yarbrough. Plaintiffs' exhibits include copies of various Minutes of the Quick Weld Board of Directors, as well as a Quick Weld balance sheet dated December 31, 1994. No other supporting

documentation, including disbursements records, checks, deposit records, statements of checking accounts, etc., are provided. The Minutes reveal set-offs of indebtedness between the Yarbroughs and Quick Weld. However, there is no evidence of actual disbursements of funds to or from either party. Since the record contains no evidence of the actual exchange of funds described in the Board minutes, the Court is reluctant to charge Charlotte Yarbrough with these amounts. Instead, the Court focuses upon the withdrawals from the Quick Weld account evidenced by the copies of checks introduced elsewhere by the plaintiffs. Therefore, the Court finds that the alleged \$150,000.00 damages sought by the plaintiffs in this category are not substantiated.

Category four of damages proposed by the plaintiffs is entitled “Escrow Funds - Catoosa County lawsuit.” Plaintiffs claim that Charlotte Yarbrough gained control of disputed funds placed in escrow with the Superior Court Clerk’s office of Catoosa County, Georgia. The lawsuit in Catoosa County was initiated by certain minority shareholders in response to a proposed sale of Quick Weld to ITW Devcon Division of Illinois Tool Works, Inc. On November 15, 1995, pending resolution of the dispute, the Superior Court ordered the deposit with the clerk’s office of 40% of the proceeds from the sale. The total amount deposited to the escrow account was \$521,093.32, which earned interest during the pendency of the lawsuit. On or about February 20, 1996, the Yarbroughs filed a “Verified Motion to Clarify Consent Order and Citation of Authorities” requesting a disbursement of \$190,600.00 from the escrowed funds for the payment of taxes owed by Quick Weld. Their motion was supported by an affidavit of an accountant retained by Quick Weld to prepare tax returns for the company. On March 13, 1996, the court clerk issued a check payable to Quick Weld, Harvey Yarbrough, and Charlotte Yarbrough for the amount requested. Plaintiffs’ exhibit #357 is a copy of the check from the court clerk and bears the endorsements of both

Charlotte and Harvey Yarbrough and the notation that the check be deposited to Quick Weld. Plaintiffs' exhibit #358 contains copies of a deposit ticket to the Quick Weld account of \$100,000.00 on March 13, 1996; a "cash-out" teller ticket of \$600.00; and a deposit to the account of "Harvey M. Yarbrough and Charlotte Yarbrough" at the Capital Bank of Ringgold, Georgia, in the amount of \$90,600.00. This disbursement resulted in a net balance to the escrow account of \$333,088.37, which included interest earned to date. Finally, on February 20, 1998, the clerk's office remitted \$351,944.64 in two transactions: check no. 5583 in the amount of \$284,444.64 to Quick Weld, Harvey Yarbrough, and Charlotte Yarbrough; and check no. 5584 in the amount of \$67,500.00 to the Catoosa County plaintiff and her attorney in the lawsuit. The plaintiffs in this case have asserted damages in the amount of 14% of the \$190,600.00 and \$284,444.64, less \$9,911.00.² Charlotte Yarbrough contends that she has no knowledge of the disposition of these funds despite her endorsement. The Court finds that on March 13, 1996, \$90,000.00 was deposited to Charlotte Yarbrough's personal account at Capital Bank in Ringgold, Georgia. Although \$600.00 was "cashed out" during the March 13, 1996, transaction and \$100,000.00 was deposited to Quick Weld's account, the record contains no evidence that Charlotte Yarbrough received these funds. Furthermore, no supporting documentation is presented concerning the disbursement of the \$284,444.64, except the Catoosa County clerk of court's check stub reflecting payment to Harvey Yarbrough, Charlotte Yarbrough, and to Quick Weld. These funds may or may not have been deposited to the Quick Weld account, cashed by the Yarbroughs, or endorsed to another party. The record simply contains no evidence of the ultimate beneficiary of these funds. Furthermore, Charlotte Yarbrough testified that she had no knowledge of the transaction,

² The 14% represents their share of Quick Weld as shareholders, and \$9,911.00 represents the amount already received by the plaintiffs.

nor did she know what happened to those funds. Therefore, the Court will adjust the damages sought by the plaintiffs to include \$90,000.00 deposited to Charlotte Yarbrough's personal account.

Category five is entitled "Miscellaneous Embezzled Funds" and contains an itemized list of checks drawn on the Quick Weld account by Charlotte Yarbrough for personal and household uses. The plaintiffs provided copies of each check and grouped them in batches with summary sheets attached. Of the items presented, two copies are illegible and one item is incorrectly entered as \$345.45 rather than \$245.45. Furthermore, some of the items included in the exhibit are checks written by Harvey Yarbrough and will be excluded from the court's calculation of damages. Finally, plaintiffs have tendered Exhibit #44 which is a copy of an account statement for a Bradford Cash Management account in the names of Harvey and Charlotte Yarbrough. The plaintiffs include check no. 154 payable from this account to RAF Financial in the amount of \$27,500.00; however, no explanation is offered for including this item as damages incurred by the plaintiffs. The plaintiffs' allegations and exhibits in support thereof are not contested by Charlotte Yarbrough; therefore, with the exceptions noted herein, the Court accepts the plaintiffs' assertions of damages as follows:

Plaintiffs' Asserted Damages:	\$99,315.14
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Adjusted Damages:

Less: 3 Items - Illegible			
Exhibit 170	\$	92.79	
Exhibit 85		10.31	
Exhibit 53		129.87	(\$232.97)
Less: RAF Financial Item			(\$27,500.00)
Incorrectly Entered Check Amount			
(\$345.45 should be \$245.45):			100.00

Less: Checks written by Harvey Yarbrough:

Exhibit 200	\$1,500.00
Exhibit 218	6,346.00
Exhibit 228	1,200.00
Exhibit 258	24.94
Exhibit 82	60.00
Exhibit 156	1,300.00
Exhibit 270	9,000.00
Exhibit 113	1,200.00
Exhibit 240	50.00
Exhibit 201	1,059.55
Exhibit 239	200.00
Exhibit 250	50.00
	<u>(\$21,990.49)</u>

Total: \$49,691.68

After the adjustments set forth herein, the Court finds that the damages to be assessed against Charlotte Yarbrough and to be declared non-dischargeable pursuant to 11 U.S.C. § 523(a)(4) are as follows:

Category I	\$ 79,979.40
Category II	181,889.38
Category III	-0-
Category IV	90,000.00
Category V	<u>49,691.68</u>

Total: \$401,560.46

\$401,560.46 x .14316 (plaintiffs' share) \$ 57,487.40

With respect to the plaintiffs' request for punitive damages, the court finds sufficient reason to justify an award of punitive damages. The bankruptcy court has the authority and the jurisdiction to determine damages, including punitive damages. *WebMD Practice Services, Inc. v. Sedlacek (In re Sedlacek)*, 327 B.R. 872, 880 (Bankr. E.D. Tenn. 2005)(citing *Haney v. Copeland (In re Copeland)*, 291 B.R. 740, 792 (Bankr. E. D. Tenn. 2003)(citing *Longo v. McLaren*

(*In re McLaren*), 3 F.3d 958, 965(6th Cir. 1993)). Charlotte Yarbrough's treatment of the corporate account and funds as interchangeable with personal funds displayed a complete disregard of her duties and responsibilities as an officer of the corporation to the detriment of the corporate shareholders. Therefore, the court imposes a judgment of punitive damages against Charlotte Yarbrough in the amount of \$50,000.00.

Finally, plaintiffs also assert that they are entitled to reasonable attorney's fees in the calculation of damages. According to Ga. Code Ann. § 14-2-746, a court may, upon termination of the derivative proceeding, order the *corporation* to pay the plaintiff's reasonable expenses, including attorney's fees, if it finds that the proceeding resulted in a substantial benefit to the corporation. In reviewing the law of Georgia, this court concludes that the statute does not preclude the successful plaintiff from recovering costs and reasonable attorney's fees directly from the corporate officers responsible for the action giving rise to the suit. In *Grizzard v. Petkas*, the Georgia Supreme Court addressed the appellant's assignment of error in the appellee's direct recovery of costs and attorney fees against the appellant in a shareholder's derivative suit. In construing an earlier version of the Georgia Code, the court quoted *Picket v. Paine*, 230 Ga. 786, 790, 199 S.E. 2d 223 (1973) for the proposition that

. . .although "[a]s a general rule, . . . complaining shareholders will not be allowed to recover *directly* [Cits.] [t]he Georgia Business Corporation Act, Code Ann. § 22-615(d), [now O.C.G.A. § 14-2-123(e)] *excepts* in this regard only costs and attorney fees as may be incurred by the minority shareholder as a result of the derivative action." (Emphasis supplied). Thus we find that O.C.G.A. § 14-2-123(e) does not prevent a shareholder's recovery of costs and attorney fees directly from the corporate officers responsible for the misconduct giving rise to the derivative action.

173 Ga. App. 629, 630, 327 S.E.2d 514, 515 (1985). See also, Walter E. Jospin and Randall W. Johnson, *Business and Commercial Law: Corporations, Other Business Organizations, and*

Securities Regulations, in 6 Ga. Jur. Corporations § 4:68 (Thompson/West 2005). Accordingly, the court finds that the plaintiffs may be awarded costs and reasonable attorney's fees. The court has reviewed the plaintiffs' post-petition brief, affidavit of counsel, and exhibits concerning the fees incurred in the prosecution of this case. Most of the efforts in the adversary proceeding were directed toward Mr. Yarbrough during the time in which he was a defendant in the case. The amount with which the court is concerned at this time is the amount to assign to Mrs. Yarbrough. In considering all of the factors involved in prosecuting this matter, including the time, effort, the number of transactions reviewed in preparation for trial and the time spent preparing the vast documentary evidence, the court determines that a reasonable attorney's fee is \$45,000.00.

This concludes the court's findings of fact and conclusions of law.

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